

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeene G. Kelly.

Calpine King City Cogen, LLC

Docket No. QF85-735-007

ORDER GRANTING CLARIFICATION

(Issued July 22, 2005)

1. In this order the Commission grants the June 6, 2005 request for clarification filed by Calpine King City Cogen, LLC (Calpine King City). Calpine King City asks that the Commission clarify its May 6, 2005 Order in this proceeding. *Calpine King City Cogen, LLC*, 111 FERC ¶ 61,174 (2005) (May 6, 2005 Order).

Background

Factual Background

2. Calpine King City owns and operates a 120 MW natural gas-fired topping-cycle cogeneration facility located in King City, California. Calpine King City sells the electric output of the facility to Pacific Gas and Electric Company (PG&E) pursuant to a long term power sales contract. Calpine King City sells the thermal output of the facility to CAG 45, Inc. (CAG). Calpine King City states that CAG is a subsidiary of ConAgra Foods, Inc., which has used the steam it purchases from Calpine King City for drying agricultural products; CAG is not affiliated with Calpine King City. According to Calpine King City, CAG is obligated by contract to purchase a sufficient amount of steam to permit Calpine King City to maintain its QF status. The Commission first certified the Calpine King City facility as a QF on February 26, 1986, in Docket No. QF85-735-000.¹

3. On May 12, 2004, Calpine King City filed a request for a limited waiver of the Commission's operating standard for qualifying facilities (QFs) because CAG had advised Calpine King City that it would curtail its food processing operations and that, as

¹ *Basic American Foods*, 34 FERC ¶ 62,411 (1986). Commission recertification due to change in upstream ownership was granted in *BAF Energy*, 41 FERC ¶ 62,070 (1987). Notices of self-recertification were filed on April 15, 1988, June 11, 1996 and May 30, 2003 to reflect changes in ownership.

a result, CAG's steam take might not be sufficient to enable Calpine King City to satisfy the Commission's operating standard for calendar year 2004. CAG also had informed Calpine King City that it intended to install a water distillation system on site and purchase steam to produce distilled water in place of the steam formerly used in the food processing operations. Once CAG's water distillation system was operating, Calpine King City represented that it would meet the Commission's operating standard. Calpine King City sought limited waiver of the Commission's operating standard to allow sufficient time for CAG to construct the water distillation system and to finalize contractual arrangements related to its construction and operation. On August 5, 2004, the Commission granted Calpine King City's request for temporary waiver of the operating standard for calendar years 2004 and 2005.²

Request for Recertification

4. On November 16, 2004, as amended on February 24, 2005, Calpine King City filed an application seeking Commission recertification of its cogeneration facility as a QF. The application described Calpine King City's sale of steam to be used in CAG's water distillation facility. In addition to recertification, and as particularly relevant here, Calpine King City sought confirmation that it may purchase all or a portion of the distilled water produced in CAG's distillation facility without jeopardizing its QF status.

5. Calpine King City explained that, following issuance of the order granting waiver of the operating standard, discussed above, Calpine King City and CAG engaged in extensive, arm's-length negotiations and finalized the contractual arrangements related to the construction and operation of the water distillation system. Pursuant to these agreements, CAG will construct and own, and Calpine King City will operate, a water distillation facility on the site of CAG's existing steam host facility. Calpine King City stated that the water distillation facility would be designed to consume, together with CAG's other operations at the existing steam host facility, an amount of steam sufficient to maintain compliance with applicable QF criteria.

6. Calpine King City stated a portion of the steam purchased by CAG would continue to be used in CAG's existing steam host facilities for the drying of agricultural products. The balance of the steam purchased by CAG would be used in CAG's new water distillation facility to produce distilled water, which would be used by CAG or transferred to others.

² *Calpine King City Cogen, LLC*, 108 FERC ¶ 61,149 (2004).

7. In its application, Calpine King City stated that it and CAG had agreed that Calpine King City may purchase the distilled water to be produced by CAG's distillation facility, provided that such purchases do not jeopardize the QF status of the cogeneration facility.

May 6, 2005 Order

8. In the May 6, 2005 Order, the Commission conditionally granted recertification of Calpine King City's cogeneration facility. The grant of Calpine King City's application for recertification was conditioned on Calpine King City's not counting as "useful thermal output" any of the thermal output sold to and used by CAG to produce distilled water that is in turn purchased back by Calpine King City.³

9. The Commission conditioned the grant of recertification, based on its finding that Calpine King City's proposed sale of thermal output to CAG, coupled with Calpine King City's purchase back of distilled water produced by the thermal output, would be, in essence, a "sham transaction," and hence Calpine King City could not consider the thermal output used to produce any distilled water bought back to be "useful" and thus includable in the calculation of compliance with the operating and efficiency standards.⁴

June 6 Request for Clarification

10. In its June 6 request for clarification, Calpine King City states that it is not seeking rehearing and that it will comply with the condition that the steam used to produce distilled water by CAG that is in turn bought back by Calpine King City will not be included its operating and efficiency calculations. Calpine King City, nevertheless, asks the Commission to clarify that Calpine King City's purchase of distilled water does not constitute a "sham transaction." Calpine King City states that the use of the phrase "sham transaction" was not necessary to the Commission's determination that the water Calpine King City proposed to purchase back from CAG had no use other than in the power production process and thus Calpine King City could not consider any of the thermal output used by CAG to produce distilled water that would then be bought back by Calpine King City to be "useful thermal output." Calpine King City states that its purchase of water from CAG is a *bona fide* commercial transaction that should not have been described as a "sham."

³ The operating and efficiency standards are contained in section 292.205 of the Commission's regulations. See 18 C.F.R. § 292.205 (2005).

⁴ May 6 Order at P 20-24.

Discussion

11. We will grant Calpine King City's request and clarify the May 6, 2005 Order. As Calpine King City points out, while the steam CAG uses to produce distilled water that will be purchased by Calpine King City may not be included in Calpine King City's operating and efficiency calculations, the record before us indicates that the contract for the purchase of water was an arm's-length transaction between non-affiliates. There was no "attempt or subterfuge designed to camouflage the actual economic essence of the transaction;" there was no "hoax" or "counterfeit."⁵

12. Rather, the Commission's use of the word "sham" was in the context of addressing whether the thermal output of a cogeneration facility was "useful" for purposes of QF certification, and that use was consistent with precedent. The word "sham" had been used in a number of cases where the issue was simply whether a QF's thermal output was "useful" for QF certification purposes.

13. In *Arroyo Energy, Limited Partnership*,⁶ the Commission looked to see if the use of thermal output constituted a "sham." The Commission explained:

Over time, the Commission has reviewed the design of numerous cogeneration facilities seeking QF status. Many have been designed in a manner revealing that the intended use of thermal energy does not serve some legitimate industrial, commercial, heating, or cooling purpose and, in reality, serves merely to help the applicant gain qualifying status under PURPA. What SDG&E wishes us to determine, or set for hearing, is the issue of whether Arroyo's proposed use of the thermal output of its facility is a bona fide use, or whether it is in essence a *sham* designed to enable the facility to obtain Commission certification as a qualifying facility. Our review of the evidence compiled in this proceeding confirms that the proposed use of the Arroyo facility's thermal output for refrigeration purposes is indeed *bona fide*. SDG&E presents us with no new reason to upset our earlier determination (62 FERC at 62,722) that the technology to be applied by Arroyo, as well as the end product, are established and, accordingly, that the thermal output of the facility is presumptively useful.

⁵ See Calpine King City Request at 3.

⁶ 63 FERC ¶ 61,198 at 62,545 (1993) (emphasis added).

14. In *Kamine/Besicorp Allegany L.P.*,⁷ the Commission likewise explained:

At that time [referring to an earlier 1988 decision], the Commission had reviewed the design of numerous cogeneration facilities seeking QF status. It was apparent that many QFs were designed in a manner revealing that the intended use of thermal energy would not serve some legitimate industrial, commercial, heating, or cooling purpose and, in reality, would serve merely to help the applicant gain qualifying status under PURPA. Thus our commonality test was in essence designed to determine whether the proposed use of the facility and its thermal output is *bona fide*, or whether it is in essence a *sham* designed to enable a facility to obtain Commission certification as a qualifying facility.

15. Here, our use of the word “sham” was in the context of determining whether the thermal output used by CAG to produce the distilled water that was then purchased by Calpine King City was, simply put, “useful” or not for QF certification purposes, and our use of the word “sham” was consistent with Commission precedent.

The Commission orders:

Calpine King City’s request for clarification is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

⁷ 63 FERC ¶ 61,320 at 63,158 (1993) (emphasis added); *accord EcoElectrica, L.P.*, 108 FERC ¶ 61,249 at P 27 (2004); *Brazos Electric Power Cooperative v. Tenaska IV Texas Power Partners*, 83 FERC ¶ 61,727, *reh’g denied*, 85 FERC ¶ 61,097 (1998), *aff’d*, 205 F.3d 235 (5th Cir. 2000).